

due to these entry barriers and the elimination of historic inefficiencies, and not primarily due to innovation by the ILECs.

Economics teaches that the continual creation and destruction of excess profits is an important force motivating innovation and entrepreneurial activity. Action by the Commission to re-base rates and lower returns to market levels in a market that is not now competitive simply mimics the destruction of excess profits that can be witnessed in competitive markets. The Commission errs fundamentally if it seeks to create or maintain a price cap system in which excess profits persist indefinitely and are not periodically destroyed by the action of competition or its surrogate, regulation.

C. The Commission Should Fashion a Hybrid Approach Using Elements of Both the Market-Based Approach and the Prescriptive Approach.

In reality, the Commission does not face a stark choice between a market-based approach and a prescriptive approach. Competition will continue to develop for exchange access, albeit possibly at a relatively slow pace. It is reasonable to assume that the use of unbundled network elements priced at forward-looking costs will begin to place some pressure on access prices. On the other hand, this pressure may not move access prices to competitive levels quickly enough. CPI suggests the following combined approach to using the two methods.

First, the Commission should take several steps to enable the market-based approach. Since the availability of UNEs is the *sine qua non* of the market-based approach, most of these

recommendations concern the degree to which competitors can enter local exchange by purchasing UNEs. These include:

- 1) eliminating the application of access charge to UNEs;
- 2) monitoring state pricing decisions applied to UNEs for consistency with TELRIC pricing standards;
- 3) adopting enhanced requirements on “back office” systems to ensure that there are minimal logistical barriers to the provision of UNEs;
- 4) consideration of additional unbundling requirements (e.g., subloop unbundling);
- 5) establishing an expedited complaint process available to purchasers of UNEs;
- 6) periodic performance audits or surveys of the RBOCs’ provision of UNEs;
- 7) possible additional de-averaging of UNE prices.<sup>12</sup>

Second, the Commission should adopt a target timeframe for the transition to economic costs.

Third, the Commission should review annually the progress of movement of prices toward that target and determine whether additional prescriptive reductions are necessary. CPI suggests that the Commission reserve the right to impose prescriptive rate reductions depending on the success of market pressures in reducing access prices. It is critical that the providers of access understand that prescriptive reductions are likely to occur if there is insufficient progress toward

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<sup>12</sup>These initiatives by the Commission can be undertaken regardless of the status of the appeal of the Commission’s Interconnection Order. The items in this list are conditions under which the Commission would determine whether the “market-based” approach for access charge reform is likely to succeed. The authority to balance the prescriptive approach and the market-based approach does not depend on an interpretation of the Commission’s authority under Section 251 of the Communications Act.

a competitive access market. Essentially, the Commission should assess each year whether the market-based approach is producing progress and decide whether additional regulatory “instalments” are required past the initial “down payment.” In this review, the Commission should consider:

- 1) actual declines in access prices;
- 2) the extent to which access prices are below price cap ceilings;
- 3) the quality of UNE provision by the ILECs;
- 4) the growth in market share of competing providers of access services, including both facilities-based providers and UNE-based access provision; and
- 5) likelihood of continued growth in competition.

**D. The Commission Should Modify the Triggers and Phases Presented in the Discussion of the Market-Based Approach**

Earlier we identified the strengths and weaknesses of the general “market-based” approach outlined by the Commission. CPI essentially recommends that the market-based approach be used in conjunction with a more prescriptive regulatory approach. We agree that, to permit market pressures to begin functioning in the exchange access market, the Commission should implement regulatory reform in phases depending upon the amount of competition that exists in a market. This approach is consistent with the Commission’s prior efforts to relax regulation of the long distance market depending upon the level of market power held by each competitor in that market. Basing the level of regulation on the competitiveness of the market is also consistent with the approach taken by Congress in enacting Section 10 of the Communications

Act, which authorizes the Commission to forbear from regulation based upon a finding of competitive market conditions.

On the other hand, CPI is concerned that the “triggers” proposed by the Commission are out-of-step with each associated phase of deregulation. For Phase I, the Commission proposes to eliminate four regulatory constraints when an incumbent LEC can demonstrate “potential competition”. The Commission proposes that this “potential competition” standard can be met by the LEC’s satisfaction of up to eight functions, many of which are similar to those found in the “competitive checklist” for RBOC entry into interLATA service under Section 271.

The elimination of the four regulatory constraints upon a showing of “potential competition” could effectively stifle the development of actual competition. On the day that the ILEC demonstrates to the Commission that it satisfies some or all of these criteria, the ILEC could lock in its existing customers with long-term contracts and make it unlikely that any competitor will enter the market. The effect of granting the ILEC premature pricing flexibility would be to discourage any competition for access services at all. CPI agrees that the ILECs should have greater flexibility in pricing access services at the point when they face actual competition, but the Commission’s proposal would give this flexibility to the ILECs prematurely.

CPI believes that the Commission should not allow an ILEC to have the pricing flexibility proposed for Phase 1 until the ILEC satisfies the “triggers” for both Phase 1 and for Phase 2. ILECs should have the right to deaverage rates and enter into volume and long-term contracts to

be able to respond to existing, actual competitors who may be offering similar rates and contracts in that market. The Commission should grant ILECs pricing flexibility only after they have met the unbundling requirements proposed for Phase 1 and after an actual competitor exists, after full implementation of competitively neutral universal service support mechanisms, and after credible and timely enforcement of pro-competitive rules.

The Commission asks whether it is sufficient if the ILEC has made its facilities and services available in a reasonable and nondiscriminatory fashion, but no competitors have entered the market. CPI disagrees with this approach. If no competitor has entered the market, there is no need to give the ILEC the pricing flexibility, since the ILEC's reasoning for such pricing flexibility is to match the competition. Further, as the Commission itself notes, "A competitive presence short of substantial competition would help to ensure that the opening of the network has happened in fact, not just in theory. . . ."<sup>13</sup>

CPI believes the same approach should apply with regard to the "triggers" for Phase 2. The Commission proposes that the ILEC should be permitted to (1) eliminate price cap service categories within baskets; (2) remove the ban on differential pricing for access among different classes of customers; (3) end mandatory rate structure rules for transport and local switching; and (4) consolidate traffic-sensitive and trunking baskets when an ILEC faces the presence of actual competition, has implemented universal service mechanisms, and has enforced pro-competitive

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<sup>13</sup>NPRM, para. 201.

rules. CPI believes that the Commission should add to these preconditions a showing by the ILEC that it faces substantial competition in that market. Furthermore, the ILEC should be required to demonstrate that it faces such substantial competition in each of the submarkets (i.e. trunking, switching, etc.). If, for instance, the Commission allows the ILEC to collapse the switching and trunking categories within a basket while it faces substantial competition only for the trunking services, the ILEC could raise its prices for switching while lowering its prices for trunking in a manner that could cause harm to competition.

CPI recognizes the difficulty that the Commission faces in collecting market share data from unregulated companies, particularly on a market-by-market basis. The Commission proposes several surrogates for market share, such as measuring by the absolute number of customer lines, residential lines, or access minutes. The difficulty of gathering this market share information, and the uncertainties of these surrogates, provides an additional reason for exercising caution before the Commission grants pricing flexibility to the ILEC on the proposed schedule.<sup>14</sup>

Finally, the Commission proposes to deregulate interstate access services that are subject to substantial competition. Once again, CPI believes that the standard for deregulating interstate access services would allow for these services to be deregulated prematurely. The proper test for deregulating services should be the standard used by the Commission in prior proceedings -- the

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<sup>14</sup>CPI believes the ILECs' ability to compete will be furthered by the rate structure changes that the Commission has proposed to implement without any showing of competition. There is thus no need to move too quickly to deregulate the ILECs' access services before actual competition has entered the market.

“market power” test. The Commission should only deregulate services once the Commission finds that the ILEC no longer has the power to raise prices and restrict output.

## **VI. Conclusion**

CPI appreciates the opportunity to comment on the Commission’s Notice of Proposed Rulemaking and respectfully requests that the Commission enter an order in this docket incorporating the recommendations made by CPI in these comments.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read "Ron Binz", is written over a horizontal line.

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